STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	:	
	:	**Docket No. 11-0280**
Proposed General Increase in Rates for Gas Service	:	
	:	**(cons.)**
The Peoples Gas Light and Coke Company	:	
	:	**Docket No. 11-0281**
Proposed General Increase in Rates for Gas Service	:	

CORRECTED REPLY BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

JOHN C. FEELEY
MICHAEL LANNON
NICOLE LUCKEY
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle Street, Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
Fax: (312) 793-1556
jfeeley@icc.illinois.gov
mlannon@icc.illlinois.gov
nluckey@icc.illinois.gove

Counsel for the Staff of the Illinois Commerce Commission

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STAFF OF THE ILLINOIS COMMERCE COMMISSION

Staff of the Illinois Commerce Commission ("Staff"), by and through its counsel, pursuant to Section 200.800 of the Rules of Practice (83 Ill. Adm. Code 200.800) of the Illinois Commerce Commission ("Commission"), respectfully submits its Reply Brief in the above-captioned matter.

I. INTRODUCTION

A. Overview/Summary

The Initial Brief of the Staff of the Illinois Commerce Commission ("Staff's Initial Brief" or "Staff IB") was served on September 22, 2011. The Initial Brief Of The People Of The State Of Illinois ("AG's Initial Brief" or "AG IB"), the Initial Brief Of The Citizens Utility Board And The City Of Chicago ("CUB-City's Initial Brief" or "CUB-City IB"), the Initial Brief of the Illinois Industrial Energy Consumers and Constellation NewEnergy-Gas Division, LLC ("IIEC-CNE-Gas' Initial Brief" or "IIEC-CNE-Gas IB"), the Initial Post-

Hearing Brief Of North Shore Gas Company And The Peoples Gas Light And Coke Company ("NS-PGL's Initial Brief" or NS-PGL IB"), the Initial Brief of Integrys Energy Services-Natural Gas, LLC ("Integrys' Initial Brief" or "Integrys IB"), and the Initial Brief Of Interstate Gas Supply of Illinois ("Interstate Gas Supply Initial Brief" or "IGS IB"), were also filed or served on September 22, 2011. An erratum to the CUB-City's Initial Brief was filed or served on September 23, 2011.

Some of the issues raised in the parties' initial briefs were addressed in Staff's Initial Brief and, in the interest of avoiding unnecessary duplication, Staff has not repeated every argument or response previously made in Staff's Initial Brief. Thus, the omission of a response to an argument that Staff previously addressed simply means that Staff stands on the position taken in Staff's Initial Brief.

B. Nature of Operations

1. North Shore

2. Peoples Gas

II. TEST YEAR (Uncontested)

III. REVENUE REQUIREMENT

Staff has made no changes to its revenue requirement schedules and has not filed the schedules (attachments A and B of Staff's Initial Brief) again with its Reply Brief. The schedules are explained on page 3 of Staff's Initial Brief.

A. North Shore

Staff's recommendations for revenue are unchanged from Staff's Initial Brief. Staff IB, p. 4.

B. Peoples Gas

Staff's recommendations for revenue are unchanged from Staff's Initial Brief. Staff IB, p. 4.

IV. RATE BASE

A. Overview/Summary/Totals

1. North Shore

Staff's recommendations for rate base are unchanged from Staff's Initial Brief. Staff IB, p. 5.

2. Peoples Gas

Staff's recommendations for rate base are unchanged from Staff's Initial Brief. Staff IB, p. 5.

B. Uncontested Issues (All Subjects Relate to NS and PGL Unless Otherwise Noted)

1. Natural Gas Prices – Working Capital Allowance - Gas in Storage

a. Specific Plant Investments – Warehouse at Manlove Field

b. Pigging Well-Head Separator Project #1

c. Pigging Well-Head Separator Project #2

2. Accumulated Depreciation Expense on Forecasted Additions and Utility Plant in Service – 2010 Actual

3. Accumulated Deferred Income Taxes

a. Bonus Depreciation, Illinois State Income Taxes and Tax Accounting Method Changes

b. Use of Average Rate Assumption Method relating to Health Care Reform Legislation

c. Net Operating Loss – Tax Normalization

C. Contested Issues

1. Plant (All Subjects Relate to NS and PGL Unless Otherwise Noted)

a. Forecasted Test Year Capital Additions

i. Utility Plant in Service

Staff has made no changes to its rate base schedules and has not filed the schedules again with its Reply Brief. The schedules, page 5 of the attachments to Staff's Initial Brief, are explained on page 9 of Staff's Initial Brief.

ii. Capital Additions Related to Accelerated Main Replacement – AMRP (PGL)

Staff has not changed its position on this issue. Staff IB, p. 9. Although Staff would support GCI witness Mr. Effron's proposed adjustment, the Companies accepted Staff's adjustment. NS-PGL Ex. 40.0 CORR., pp. 3 – 4. Accepting both Staff's and Mr. Effron's adjustments could result in double counting. If the Commission were to accept Mr. Effron's proposed adjustment, all or a portion of Staff's adjustment to forecasted plant additions should be removed from People Gas' revenue requirement.

Staff questions the statement made by the Companies that Peoples Gas would have to limit the 2011-2012 expenditures to what the Commission allows, resulting in delay and higher costs. NS-PGL IB, p. 7. Following this logic, one would expect Peoples Gas to never have plant additions during the period between rate cases because those plant additions would not yet be reflected in rates. This is inconsistent with the Companies' own evidence in this case which demonstrates the Company had plant additions every year regardless of when rate increases go into effect. PGL Ex. 7.1, Schedule B-5.

b. Capitalized Incentive Compensation (see also Section V.C.1)

c. Non-Union Wages (see also Section V.C.2)

d. Original Cost Determination as to Plant Balances as of December 31, 2009

Staff takes issue with the Companies' recommendation to include language in the final order stating that the Companies' figures should be approved if a decision in the appeals or any other proceeding results in the plant in question being approved. NS-PGL IB, p. 20. Under the PUA, the pendency of an appeal does not of itself stay or suspend a decision of the Commission. 220 ILCS 5/10-204. Therefore, the Commission should adjust original costs in accordance with its order in the previous docket 07-0241/0242 (Staff Ex. 1.0 and 10.0, pp. 19 – 20) and should not include alternative language in the event that prior Commission orders are found reversed. In fact as discussed elsewhere in this reply brief the Commission's order in the Companies 2009 rate cases was upheld on appeal with the exception of Rider ICR. People v. Illinois Commerce Comm'n, Nos. 1-10-0654, 1-10-0655, 1-10-0936, 1-10-179-, 1-10-1846 and

1-10-1852, Consolidated, Appellate Court (First District-Fifth Division) September 30, 2011, Slip Opinion, p. 28.

Since filing its initial brief, it was brought to Staff's attention that Staff's proposed reductions to original costs (Staff Ex. 1.0 and 10.0, pp. 19 – 20) include adjustments from Docket Nos. 09-0166/09-0167 (cons) which applied to those proceedings 2010 test year. Since the original costs in the instant proceeding are as of December 31, 2009, it would not be appropriate at this time to make a reduction to the December 31, 2009 balance for adjustments that pertain to a subsequent period. For North Shore, the Company's proposed original cost of $411,643,000 (NS Ex. 7.0, p. 2) should be reduced by $27,000. For Peoples Gas, the Company's proposed original cost of $2,667,949,000 (PGL Ex. 7.0, p 2) should be reduced by $166,000. The adjustments are discussed in pages 16 – 17 of Staff Exhibit 3.0 Corrected.

Staff recommends that the Commission order state:

> It is further ordered that an original cost of plant of $411,616,000 for North Shore at December 31, 2009, and an original cost of plant of $2,667,783,000 for Peoples Gas at December 31, 2009 are unconditionally approved as the original costs of plant.

2. Materials and Supplies – Computation of Associated Accounts Payable

Staff's proposal for Accounts Payable with materials and supplies inventory is based on an actual analysis provided by the Companies rather than the GCI estimate. Staff's proposal should be approved by the Commission. The Companies argue that a lead-lag study can be used only for the determination of a CWC requirement in rate base and nothing else. NSPGL IB, pp. 20-21. The Companies are incorrect. By definition, a lead lag study determines the time lag between the receipt of items purchased and the payment for those purchases. As discussed in the direct testimony of Company witness Hengtgen, “An expense lead represents the time between when a good is received or service is provided and when Peoples Gas pays for that good or service.” PGL Ex. 7.0, p. 27 and NS Ex. 7.0, p. 24. This timing difference is consistent with the amount of time the cost of an item is included in Accounts Payable. As discussed in Staff’s Initial Brief, the proposal made by GCI witness Morgan (and accepted by the Companies) assumes 30 days for payment of Materials and Supplies purchases while Staff’s proposal, based on the results of the lead lag study uses 42.44 days and 46.62 days for NS and PGL, respectively. Staff IB, p. 11. The dispute here between Staff and the Companies is about the timing of purchases and payments and the lead lag study addresses this directly. Staff’s proposal provides a more reasonable derivation based on record evidence and should be approved.

3. Gas in Storage – Computation of Associated Accounts Payable

Staff’s proposal for accounts payable associated with gas in storage should be approved because it more accurately reflects the reality of the accounts payable actually recorded by the Companies. The Companies argue that the accounts payable associated with the cost of gas is somehow tied to the methodology used for accounting for its stored gas inventory. NSPGL IB, pp. 21-22. Company witness Hengtgen explained in detail the timing of payments for the purchases of gas. PGL Ex. 7.0, pp. 28-29 and NS Ex. 7.0, pp. 24-26. Company Schedule F-8 clearly shows purchases are made every month of the year; therefore accounts payable associated with those purchases would also be reflected on the Companies books monthly, not just during those months in which a net increase in gas in storage occurs. Staff IB, p. 12. While Staff did consider the Companies arguments concerning LIFO inventory valuation, Staff believes its proposal for accounts payable is a more accurate representation than the alternative considered. Id., pp. 12-13.

Staff's counter to the Companies' argument concerning the use of lead lag study information for the determination of accounts payable is included under C.2. above.

4. Cash Working Capital

a. Pass-Through Taxes

Staff continues to support using revenue lag days of zero for pass-through taxes. Staff IB, p. 13. The Companies' response to Staff's position in their Initial Brief contains a series of true statements about revenue lag, but those statements are irrelevant to the analysis and do not address Staff's argument. For example, the Companies state that pass-through taxes and energy assistance charges are included in ratepayers' monthly bills and payments. NS-PGL IB, p. 25. While this is true, the Companies confuse form with substance. The method by which the Companies collect the pass-through taxes does not change the substance of pass-through taxes, and the method by which pass-through taxes are transferred from ratepayers to taxing authorities does not change their substance. In arguing that Staff's proposal should not be adopted, the Companies define revenue lag as the number of days from the date service was rendered by the utilities until the date payment was received from customers and such funds become available to the utilities. NS Ex. 7.0, p. 19; PGL Ex. 7.0, p. 22. By the Companies' definition, pass-through taxes cannot have revenue lag since there is no date on which service was rendered by the utilities. Additionally, the Companies support their argument by stating that they are required to collect and transmit pass-through taxes. NS-PGL IB, p. 26. This is also true, but again, provides no evidence or valid basis for the argument that pass-through taxes should be considered as revenue.

The Companies put stock in prior Commission decisions on this issue that favor the Companies' treatment of pass-through taxes. NS-PGL IB, p. 25. Staff asserts that while consistency is desirable, the Commission is not bound by prior decisions. The Commission's conclusion in this proceeding should stand on the facts presented in this proceeding and the facts in this proceeding support a finding of zero revenue lag days for pass-through taxes.

The Companies wish to ignore recent rate cases in which the Commission has determined that pass-through taxes should have zero revenue lag days. NS-PGL IB, p. 27. These recent rate cases are described in Staff's Initial Brief. Staff IB, p. 14. In particular, while the Companies note that they are dissimilar from Commonwealth Edison Company (Docket No. 10-0467) ("ComEd") in that ComEd is an electric utility while Peoples Gas and North Shore are gas utilities, the Companies fail to acknowledge the many aspects in which ComEd is similar to the Companies. ComEd also operates in the Chicago metropolitan area and has Energy Assistance Charges and Gross Receipts/Municipal Utility Taxes included in its CWC calculation with zero revenue lag days and zero expense lead days. 10-0467 Order at 17.

The Companies point out that Energy Assistance Charges are described in statute as a charge for utility service. NS-PGL IB, p. 26. Staff agrees with that statement but would point out that Energy Assistance Charges have been treated as pass-through taxes by the Commission in the prior rate proceedings of the Companies.

Additionally, the treatment of Energy Assistance Charges as pass-through taxes is consistent with the Companies' inclusion of Energy Assistance Charges with all other pass-through taxes in their initial filing of Schedule C-25. For ratemaking purposes, there is no precedent for Energy Assistance Charges to be considered a charge for utility service.

The Companies suppose that if pass-through taxes are not recorded as expense in the revenue requirement, that pass-through taxes could not have an expense lead. NS-PGL IB, p. 26. This logic is flawed because it ignores the Companies ability to collect ratepayer funds and hold those funds until they are remitted to taxing authorities. Some pass-through taxes are remitted to the taxing agencies prior to collection from ratepayers and some pass-through taxes are remitted after collection from ratepayers. This effect on CWC is taken into account in Staff's CWC calculation. Staff IB Appendix A, p. 11, lines 16 – 19; Staff IB Appendix B, p. 11, lines 17 – 21.

The Companies clearly lay out the number of days they could hold ratepayer funds before remitting those funds to taxing authorities. These calculations, according to Mr. Hengtgen's testimony, are based upon when the taxes are collected from ratepayers and when they are due to taxing authorities. NS-PGL Ex. 23.0 CORRECTED, p. 21. Staff incorporated these calculations in its rebuttal position. Staff Ex. 10.0, p. 8.

Cash Working Capital is included in rate base to allow investors to recover the cost of financing operating expenses until operating revenue is collected. The collection of pass-through taxes is not the recovery of a cost of providing service; therefore, pass-through taxes are not included in the revenue requirement. Because ratepayers provide the financing for pass-through taxes, the Commission should not allow a revenue lag for pass-through taxes which would allow investors to earn a return on ratepayer provided funds.

The Commission should accept the Cash Working Capital levels recommended by Staff on page 11 of Appendices A and B to Staff's Initial Brief.

b. Prepayments (Uncontested)

c. All Other (Uncontested)

5. Retirement Benefits, Net

a. Pension Asset

The Companies argue that exclusion of the so called pension asset from rate base would be contrary to the law. In support of their argument the Companies state the "Supreme Court of Illinois previously has rejected a claim that a utility's rate base should be reduced on the theory that part of it was the product of customers supplied funds." (citing Citizens Utilities, 124 Ill.2d at 201-203, 204-205) NS-PGL IB, pp. 33-34. The Companies argument is simply wrong and therefore should be rejected. Under Illinois law, for ratemaking purposes, a public utility may not receive a return on investment from ratepayers for ratepayer-supplied funds. City of Alton v. Illinois Commerce Commission, 19 Ill. 2d 76, 85-6 and 91 (1960); DuPage Utility Co. v. Illinois Commerce Commission, 47 Ill. 2d 550, 554 and 558 (1971); and Central Illinois Light Co. v. Illinois Commerce Commission, 252 Ill. App. 3d 577, 583-3 (3rd Dist., 1993). See also Business and Professional People for the Public Interest v. Illinois Commerce Commission ("BPI II"), 146 Ill. 2d 175, 258 (1991). Staff Witness Ebrey testified that "[t]he pension asset should not be included in rate base because it was not created with funds supplied by shareholders. Rather, the pension asset has been funded from normal operating revenues collected from utility ratepayers and represents funds supplied by ratepayers, as evidenced by the Companies' responses to Staff data requests ("DR") TEE 9.01 and TEE 9.02 (Attachments A and B). The only source of funds provided in those responses is "cash provided by operating activities" or cash provided by ratepayers. Since the pension asset was funded by normal operations, rather than provided by shareholders, shareholders should not earn a return on it." Staff Ex. 3.0 Corrected, pp. 3-4.

The Commission has consistently rejected the attempts by utilities to get a return on these ratepayer-supplied funds whether OPEB or more generally the pension asset. Central Illinois Light Co. d/b/a AmerenCILCO, et al., Ill.C.C. Docket Nos. 06-0070, 06-0071, and 06-0072, (cons.), Order of November 21, 2006, pp. 27-28, Comm. App., pp. A50-A51; Northern Illinois Gas Company d/b/a Nicor Gas Company, Ill.C.C. Docket No. 04-0779, Order of September 20, 2005, p. 26, 2005 Ill. PUC LEXIS 475, *56-*58, 245 P.U.R.4th 194, --, Comm. App., pp. A52-A53; Northern Illinois Gas Co. ("Nigas"), Ill.C.C. Docket No. 95-0219, Order of April 3, 1996, pp. 9-10, 1996 Ill. PUC LEXIS 204, *19-*23, Comm. App., pp. A43-A44, *affd. sub nom*. Nigas, et al. v. Illinois Commerce Commission, Order of June 23, 1997, Appeal Nos. 3-96-0473, etc. (cons.); and GTE North Inc., Ill.C.C. Docket Nos. 93-0301 and 94-0041 (cons.), Order of October 11, 1994, pp. 8-13, 1994 Ill. PUC LEXIS 436, *16-*26, Comm. App., pp. A 39-A42, *affd. sub nom.* Citizens Utility Board, et al. v. Illinois Commerce Commission, Order of July 12, 1995, Appellate Court Docket Nos. 4-94-1103, 4-94-1104 and 4-94-1122 (cons.), *cert den*. December 6, 1995, Sup. Ct. Docket

No. 79931, Petition of GTE North. See also Citizens Utility Board v. Illinois Commerce Commission, 166 Ill. 2d 111, 132 (1995) [Commission is unauthorized to depart drastically from practices established in earlier orders] and Mississippi River Fuel Corp. v. Illinois Commerce Commission, 1 Ill. 2d 509, 514 (1953) [long-term consistent actions by the Commission can constitute a binding statutory construction].

On September 30, 2011, the First District Appellate Court issued its opinion regarding the appeal of the Companies' 2009 rate cases (ICC Docket No. 09-0166/0167) and one of the issues on appeal concerned the Companies Pension Asset. People v. Illinois Commerce Comm'n, Nos. 1-10-0654, 1-10-0655, 1-10-0936, 1-10-179-, 1-10-1846 and 1-10-1852, Consolidated, Appellate Court (First District-Fifth Division) September 30, 2011, Slip Opinion, pp. 36-43. In that appeal, like in this proceeding, the Companies argued with respect to the pension asset issue that in Citizens Utilities Co. of Illinois v. Illinois Commerce Commission the Supreme Court rejected a claim that a utility's rate base should be reduced on the theory that part of it was the product of consumer-supplied funds. Id., p. 39. The Appellate Court in response to that argument stated that because it was not faced with the issue of retroactive ratemaking "we find Citizen's Utilities Co. provides little guidance as to how the resolve the actual issue pending … ." Id. p. 42. The Appellate Court then went on to uphold the Commission's decision to exclude the pension asset from ratebase on the basis that it consisted of consumer-supplied funds. Id., pp. 42-43.

The Companies make much of their novel argument that, a portion of what ratepayers pay through a rate is a return on investment and that contributes to retained earnings, as if it is an important fact that has not been addressed by courts in prior cases. NS-PGL IB, p. 32. This argument ignores the simple fact that the source of that cash was from ratepayers and under the law a public utility may not receive a return on investment from ratepayers for ratepayer-supplied funds. Based upon all of the arguments made above and those set forth in Staff's IB and Ms. Ebrey's direct and rebuttal testimonies the Companies' position should be rejected.

6. Accumulated Deferred Income Taxes –

a. 50/50 Sharing Related to Tax Accounting Method Changes

Staff has not changed its position on this issue. Staff IB, p. 18. Staff believes that the Commission should not discourage utilities from taking tax positions that have some risk associated with them when such positions are appropriate and could benefit ratepayers. The Companies may benefit from ratepayer provided "free" or low cost capital in the short term, but if the Companies prevail, ratepayers will receive 100% of the benefit of reduced rate base in succeeding rate cases. Staff Ex. 10.0, pp. 23-24.

b. Derivative Adjustments from Contested Adjustments

Staff's position is that once a decision is made on the contested adjustments any derivative adjustments fall out of the formulae. Staff is not aware of any dispute over those formulae used to make the derivative adjustments. Staff IB, p. 18.

D. Accumulated Depreciation (Uncontested Except for Derivative Adjustments from Contested Adjustments)

Staff's position is that once a decision is made on the contested adjustments any derivative adjustments fall out of the formulae. Staff is not aware of any dispute over those formulae used to make the derivative adjustments. Staff IB, p. 18.

V. OPERATING EXPENSES

A. Overview/Summary/Totals

1. North Shore

Staff's recommendations for operating expenses are unchanged from Staff's Initial Brief. Staff IB, p. 19.

2. Peoples Gas

Staff's recommendations for operating expenses are unchanged from Staff's Initial Brief. Staff IB, p. 19.

B. Uncontested Issues

1. Physical Gas Losses

a. Modify Method of Accounting for Physical Gas Losses Associated with Manlove Field (PGL)

b. Amend written procedures for treatment of physical losses of gas from underground storage fields (PGL)

2. Distribution O&M

a. Expenses for locates, leak surveys, disconnects (O&M – PGL)

b. Building Costs (PGL)

3. Distribution O&M – adjustment to reflect costs that should have been capitalized instead of expensed

4. Distribution O&M - Inflation

5. Distribution O&M - Building Lease (PGL)

6. Customer Service and Information

a. Advertising

7. Administrative & General

a. Interest Expense on Budget Payment Plan

b. Interest Expense on Customer Deposits

c. Lobbying

d. Social and Service Club Dues

e. Civic, Political, and Related

f. Charitable Contributions – Reclassification of 2012 costs

g. Inflation Factor Error-Miscellaneous Expense

i. Inflation Rate Update

ii. Inflation Factor Error

h. Employee Benefits – Adjustment to Test Year Pension and Benefits Expenses to Reflect Most Recent Actuarial Report

i. Integrys Business Support Benefits Billed Expense

j. Advertising

8. Depreciation Expense on Utility Plant in Service – 2010 Actual

9. Current Income Taxes –

a. Bonus Depreciation, Illinois State Income Taxes and Tax Accounting Method Changes

b. Reclassification of Income Taxes on Charitable Contributions

10. Invested Capital Tax (derivative adjustments)

11. Interest Synchronization (derivative adjustments)

12. Updated Inflation Rate

13. Rate 4 Revenues (NS)

C. Contested Issues

1. Incentive Compensation

The Companies argue that:

> The Commission cannot ignore the uncontradicted evidence regarding the prudence and reasonableness of the incentive compensation costs or the benefits received by customers. The Commission must apply Illinois law governing uncontradicted evidence. "Where the testimony of a witness is neither contradicted, either by positive testimony or by circumstances, nor inherently improbable, and the witness has not been impeached, that testimony cannot be disregarded by the trier of fact." *Bazydlo v. Volant*, 164 Ill. 2d 207, 215, 647 N.E.2d 273, 277 (1995).

NS-PGL IB, p. 62. The Companies' view is flatly inconsistent with the court's decision in Commonwealth Edison Co. v. Ill. Commerce Comm'n, 398 Ill. App. 3d 510, 516-17 (2nd

Dist. 2009). Thus whether or not "uncontradicted" evidence showed that the costs were reasonably and prudently incurred is irrelevant to the issue of recoverability. Long ago, in Illinois Bell Telephone Co. v. Illinois Commerce Comm'n, 55 Ill.2d 461, 481 (1973), the Illinois Supreme Court affirmed a Commission decision which disallowed cost for recovery for expenditures for dues to civic, social and athletic clubs as they were held not to be "operating expenses to be considered in the fixing of rates." There, as here and in Commonwealth Edison, those expenditures were properly denied recovery even though such expenditures "[u]ndoubtedly . . . would be the sort of perk that would help an employer recruit employees." Commonwealth Edison Co. v. Ill. Commerce Comm'n, 398 Ill. App. 3d 519 (Emphasis added). Put simply, in the absence of a demonstrated direct benefit to ratepayers, even otherwise just and reasonable cost cannot be recovered.

The Companies also argue that "[i]t is settled law, moreover, that employee salaries are operating expenses and, as such, are recoverable in full so long as they are prudent and reasonable. See, e.g. *Villages of Milford v. Illinois Commerce Comm'n*, 20 Ill.2d 556, 565, 170 N.E.2d 576, 581 (1960) ("*Milford*")." The Companies also argue that "the present case is distinguishable from *Commonwealth Edison Co. v. Illinois Commerce Comm'n*, 398 Ill. App. 3d 510." NS-PGL IB, p. 63, stating that the courts "reliance in ComEd 2009 [i.e. *Commonwealth Edison Co. v. Illinois Commerce Comm'n*, 398 Ill. App. 3d 510] on *DuPage Util. Co. v. Illinois Commerce Commission*, 47 Ill. 2d 550, 560 ("*DuPage*"), which distinguished *Milford*, is inapplicable here." NS-PGL IB, p. 63. The Companies continue by arguing that in "*DuPage,* the Court distinguished *Mileford*, basing its decision on evidentiary supported findings that the salaries of three officers of a company serving 840 customers were excessive rather than reasonable, including evidence that the officers only worked-part time and maintained only a minimal contact with the utility's day to day operations, and the salaries were disproportionately high compared to comparable utilities." Id. The Companies go onto argue that "[t]here is no claim, much less any evidence, of excessive compensation on those or any other grounds in the instant cases." Id.

Despite the Companies' claim, this proceeding is not distinguishable from Commonwealth Edison Co. v. Illinois Commerce Comm'n, 398 Ill. App. 3d 510. The Companies attempt to undercut the Commonwealth Edison decision by reference to the Supreme Court's decision in Du Page Utility Co. v. Illinois Commerce Comm'n, 47 Ill. 2d 550, 560-61 (1971) should be disregarded. In DuPage the Commission disallowed the recovery of certain annual employee salaries on the basis that they were excessive and out of proportion to the extent and nature of the services performed. Whether or not the Commission in that case determined that the salaries were "excessive" in part and therefore disallowed in part does not undermine, and in fact supports, the conclusion that expenses which are not shown to benefit ratepayers are not to be included in rates.

Whether the Commission made a finding that the salaries were excessive and therefore unrecoverable or it made a finding that costs, though otherwise reasonable expenses for an ordinary corporation, did not provide direct benefits to ratepayers is of little import when the result is the same. Without a direct benefit to ratepayers, incentive compensation costs can and should be disallowed. In this proceeding, like the Commonwealth Edison proceeding, there has been a failure by a utility to show a direct benefit to rate payers for certain incentive compensation expenses. See, Staff Ex. 12.0

Corrected, pp. 5-12. Accordingly, without a direct benefit to ratepayers those incentive compensation costs must be disallowed.

On September 30, 2011, the First District Appellate Court issued its opinion regarding the appeal of the Companies' 2009 rate cases (ICC Docket No. 09-0166/0167) and one of the issues on appeal concerned the Companies Incentive Compensation Costs. People v. Illinois Commerce Comm'n, Nos. 1-10-0654, 1-10-0655, 1-10-0936, 1-10-179-, 1-10-1846 and 1-10-1852, Consolidated, Appellate Court (First District-Fifth Division) September 30, 2011, Slip Opinion, pp. 29-36. The Court upheld the Commission's order on the issue of incentive compensation costs. The Court held that "Illinois law supports the Commission's use of a direct benefit standard" in denying [ ] incentive compensation costs." Id., p. 32. In addition, the Court rejected arguments similar to those made by the Companies in their IB in this proceeding that tried to distinguish Commonwealth Edison Co. v. Illinois Commerce Comm'n, 398 Ill. App. 3d 510. The court stated "[c]ontrary to Peoples Gas' contentions on appeal, both the Act and Illinois case law clearly reflect the direct customer benefit standard was an appropriate standard for the Commission to apply… . People v. Illinois Commerce Comm'n, Nos. 1-10-0654, 1-10-0655, 1-10-0936, 1-10-179-, 1-10-1846 and 1-10-1852, Consolidated, Appellate Court (First District-Fifth Division) September 30, 2011, Slip Opinion, p. 35.

2. Non-union Base Wages

The Companies mischaracterize Staff's observation regarding the 3.9% wage increase. Staff does not assume that all employees will be elevated to "top-performer" status (NSPGL IB, p. 66) but rather that the highest performers for the utilities would be receiving increases even higher than the cited survey[1] would indicate. Staff IB, p. 30. The Companies did not provide any explanation of why their "top-performers" would receive increases well above the average for top-performers in the survey used as support for their position for why the increases budgeted for 2011 and 2012 would be almost double the increase granted in 2010. Id. Staff's analysis, as well as the historic data presented by Staff, support the recommendation to limit the non-union wage increases to those presented in the IB revenue requirements.

3. Headcounts

4. Self-Constructed Property

GCI Witness Effron continues to recommend a reduction of $1.722 million of Peoples Gas' test year operating expenses for self-constructed property costs and advocates that such amount be added to rate base. CUB-City IB, pp. 18-19. Staff's and People Gas' witnesses acknowledged, via cross-examination by GCI, that the Uniform System of Accounts permits the subject costs to be capitalized. Tr., August 30, 2011, 284:6-287:11 (Ostrander) and Tr., September 2, 2011, 922:12-925:9 (Gregor). However, GCI failed to demonstrate that capitalizing self-constructed property costs is the only proper treatment allowed by the Uniform System of Accounts. NS-PGL IB, pp. 69-70. None of the other Integrys regulated utilities capitalize indirect overhead costs of self-constructed property. The policy of capitalizing the subject indirect overhead costs was implemented mainly to assist the Companies' tax department in meeting requirements under the Tax Reform Act of 1986. The tax department has now filed with

[1] The Companies offered the World at Work Salary Budget Survey. Staff's analysis of the July 2010 and July 2011 surveys provided the basis for Staff's conclusions regarding the level of increase for top performers.

the Internal Revenue Service for a different means of calculating such indirect costs. Staff IB, p. 32. Based upon the above arguments and those previously stated in Staff's Initial Brief, Staff continues to believe that Mr. Effron's proposed adjustment for self constructed property is not necessary.

5. Uncollectibles Expenses – Use of Net Write-Off Method

Staff continues to recommend that the Commission establish uncollectibles expense percentages of 0.5936% for North Shore Gas and as 2.7927% for Peoples Gas. Staff Ex. 1.0, p. 23. Staff also continues to recommend that the Commission order the Companies to switch to the net write-off method in Rider UEA.

The Companies attempt to promote the percentage of revenues method because the method is easier to calculate. NS-PGL IB, 71. The argument that the percentage of revenues method is easier to calculate has no merit. The percentage of revenues method produces an amount of uncollectible expense that represents an estimate of future uncollectible expense on the revenues billed but not yet collected for the current period and prior periods. In comparison, the net write-off method uses actual amounts written off during the period and does not have to be calculated or estimated. The amounts written off are an accurate measure of the amount of lost revenue the Companies should be allowed to recover. In addition, actual information is preferable to estimates since it is more accurate, and should be used whenever available. Staff IB, p. 90. The Companies also argue that the net write-off method creates a mismatch issue. NS-PGL IB, p. 71. The Companies' method, however, is dependent on estimates and write-offs from prior years in its calculation. If there is a problem with multiple years and writing-off combined purchased gas adjustment charges and base rate charges, the problem already exists and would not be created by adopting Staff's proposal to use the net write-off method. Staff Ex. 10.0, p. 19.

6. Administrative & General

a. Injuries and Damages Expenses

GCI Witness Effron continues to recommend the disallowance of $3.077 million of Peoples Gas' test year operating expenses for injuries and damages expenses. Mr. Effron continues to posit that Peoples Gas has failed to adequately support the increase in allocated expenses from IBS. AG IB, pp. 20-21. In surrebuttal testimony, Peoples Gas reduced its 2012 test year expenses by $1.433 million based on an updated 2012 forecast. NS-PGL IB, p. 72. The adjusted 2012 amount of injuries and damages expenses of $12.142 million represents a 5.97% reduction from historical 2009 injuries and damages expenses of $12.913 million. Staff continues to believe that Mr. Effron's proposed adjustment is not necessary since the Companies have adequately supported the increase in injuries and damages expenses. Staff IB, pp. 33-34.

b. Adjustment to Account 921- Office Supplies and Expenses

The only contested issue pertaining to Adjustment to Account 921 – Office Supplies and Expenses concerns self constructed property. Please refer to Section V.C.4 of Staff's Reply Brief.

c. Rate Case Expenses

i. Rate Case Expenses – Docket Nos. 11-0280/0281 (cons)

The Companies agree that if the Commission approves Staff's disallowance of incentive compensation expenses as documented in Section V.C.1 of Staff's Initial Brief, then the rate case expenses related to Non-Executive Incentive plan costs should also be disallowed. In addition, subject to the Commission's approval of Staff's adjustments, the Companies agree with Staff's recommended conclusion in the Commission's Order as documented in Staff Exhibit 11.0 Corrected, p. 7, with the inclusion of "and updated in the Utilities' surrebuttal" following "adjusted by staff". NS-PGL IB, p. 76. Staff agrees with the inclusion of the Companies' proposed addition to the recommended conclusion in the Commission's Order.

ii. Amortization of Rate Case Expenses associated with Docket Nos. 09-0166/0167 (cons)

The Companies agree that the calculation of the amount of 2009 rate case expenses to be amortized should be based on actual costs up to the amount approved by the Commission. The Companies continue to contest Staff's proposed adjustments to exclude costs related to rehearing and appeals for the 2009 rate cases claiming that the excluded costs are a common part of litigation of a general rate case. NS-PGL IB, p. 78. The Companies' proposal for the amortization of the prior rate case expenses includes items and amounts which were not previously approved by the Commission. ICC Staff Exhibit 11.0, pp. 8-9. The adjustments recommended by Staff to amortize the remaining actual costs incurred, excluding any rehearing costs, for Docket Nos. 09-0166/0167 are appropriate and should be adopted by the Commission.

iii. Normalization of Rate Case Expenses

GCI Witness Morgan continues to recommend the normalization of rate case expenses instead of the regulatory asset treatment. CUB-City IB, p. 25. Staff and the Companies remain opposed to Mr. Morgan's normalization proposal. As was stated in Staff's Initial Brief, the Commission ordered the initiation of a rulemaking regarding rate case expense in Docket No. 10-0467 and it is possible that this general practice may be an issue in that proceeding. It would not be appropriate to revise the general practice before the Commission has the opportunity to consider various alternatives in the rulemaking. Staff IB, pp. 36-37.

d. Gas Transportation Administrative Costs

e. Solicitation Expense

The Commission should accept Staff witness Sackett's proposed adjustment to the expenses billed to the Companies from their affiliated service company Integrys Business Support ("IBS"). In its initial brief, Staff explained why such an adjustment was appropriate. Staff IB, pp. 37-47.

In their brief, the Companies object to any adjustment stating, "The Utilities have reflected appropriate and reasonable cost-based figures for those IBS solicitation revenues in their forecasts for the 2012 test year, a total of $16,572, so no adjustment is proper or necessary. Gregor Sur., NS-PGL Ex. 38.0, 7:142 – 8:164,9:171-183." NS-PGL IB, p. 80.

The Companies' attempt to prove these expenses are already included in rates by citing their witness' assertion that, "…the 2012 test year expenses for IBS include an appropriate amount of costs billed to PEHS for customer relations activities including solicitation and the handling of PEHS customer inquiries. Therefore, Mr. Sackett's proposed adjustment is unnecessary….the current test year reflects an appropriate level of billings to PEHS." NS-PGL Ex. 38.0, pp. 7-9. However, as Staff pointed out in its Initial Brief, Ms. Gregor states that the inclusion cannot be verified. Indeed, the Companies assert that such proof is not available, because it does "not show up as an identifiable amount on any … schedules." Staff Cross Ex. 15, p. 9; Companies response to Staff DR DAS 13.03e. The Commission should not consider such unreliable information, especially when, as shown in Staff's brief, there is evidence that this amount is provided below the Fully Distributed Cost ("FDC"). The Companies appeared to alter this position in surrebuttal, and thus Staff was unable to conduct a thorough discovery on the inclusion of this amount. This new estimate from surrebuttal is one-fourth of the estimate presented in rebuttal testimony. Their shifting position creates more than enough uncertainty about the Companies' current estimate's validity to require the Commission to reject it.

The Companies also claim that, "Any errors made by IBS in prior years by not billing PEHS the right amounts do not alter the correctness of the 2012 test year figures." Id. at 9:184-190." NS-PGL IB, p. 80. This point is moot. The Companies simply provided no proof that they included these charges in the test year.

The Companies appear to have violated both of the relevant agreements, not only for solicitation but also for billing and repairs. The Companies, via their affiliate PEHS, have a clear motive to profit from PPP. Staff IB, at 50-51 (Commission should investigate to prevent "ratepayers from continuing to subsidize the affiliates."). The Commission should not blindly trust the Companies on this issue, but instead rely upon the record developed in this docket.

Lastly, the Companies argue that "the correct calculation is cost-based under the Master Non-Regulated Affiliated Interest Agreement. Gregor Sur., NS-PGL Ex. 38.0, 7:138-141, 8:165-170." NS-PGL IB, pp. 80-81. As Staff pointed out, there is sufficient evidence that the credits in the test year for services to be provided to PEHS are not “cost-based” as required but rather *below* Fully Distributed Costs, Staff IB, pp. 44-45, thus the agreement cannot have been the guiding standard for determining the credit to ratepayers. If the Companies’ affiliate IBS fails to charge PEHS or if they choose to charge them less than the FDC for these services, then Staff recommends that the Commission credit the ratepayers directly. Due to the fact that the evidence demonstrates that these costs were not correctly assigned to the affiliates, there is no good estimate of what those FDC are. Staff believes that the most reasonable credit is what that solicitation is *worth* to PEHS. IGS provides in its Initial Brief a discussion of the value of the “unique and impossible-to-duplicate nature of some of the solicitation opportunities the Companies provide to PEHS.” IGS IB, p.7-8. The margin that PEHS makes on PPP is a good measure of the market value of those exclusive solicitation channels. Staff witness Sackett calculated an unrefuted estimate of that margin in his rebuttal testimony and the Companies did not object to that amount. Staff believes that this estimate provides the Commission with the most reasonable credit to ratepayers.

Staff continues to recommend that the Commission draw four conclusions from this evidence: (1) there is no evidence of any credit in the original test year expenses for customers relations services provided by IBS for PEHS; (2) the estimates provided by the Companies are not the full costs of providing these services as required under the governing agreement; (3) since there is no established estimate of FDC, another adjustment should be used; and (4) the adjustment should be based on the market value of these services. The Commission should utilize the estimate of this market value provided by Staff Witness Sackett, which is based on the margin of $656,267 and $116,361 that PEHS makes on PPP for Peoples Gas and North Shore respectively.

Staff Ex. 18.0, p. 23. This margin was never refuted by the Companies. Only Staff's proposal ensures that ratepayers receive the full benefit for all value of these services to PEHS.

In the alternative, if the Commission determines that Staff's proposed amount is not warranted, Staff continues to recommend that the adjustment of $70,000 contained in the Companies rebuttal testimony is more appropriate than their surrebuttal testimony recommendation of no adjustment.

7. Depreciation

a. Depreciation Expense on Forecasted Additions

The argument for Depreciation Expense on Forecasted Additions is contained in Section C. 1. A. (i).

b. Derivative Adjustments from Contested Adjustments

Staff's position is that once a decision is made on the contested adjustments any derivative adjustments fall out of the formulae. Staff is not aware of any dispute over those formulae used to make the derivative adjustments.

8. Revenues

a. Repair Revenues

In Staff's Initial Brief, it recommended that the Commission should approve an alternate "pricing mechanism" where the affiliate must pay the ratepayer rate. Staff's position is based on the fact that the Companies have admitted that they do not charge their affiliates the FDC of providing repair services. Staff IB, pp. 47-49.

The Companies continue to claim that, "Under the Commission-approved Services and Transfers Agreement, which applies here, the Utilities are to bill PEHS at the FDC of providing the service. Gregor Sur., NS-PGL Ex. 38.0, 10:197-204." NS-PGL IB, p. 82. This is incorrect. As noted in Staff's Initial Brief, the STA instead requires that the default, primary charge is a "pricing mechanism approved by the Commission." Staff Ex. 9.0, Attachment F, p. 6. The Companies acknowledge that they have been charging below FDC from 2008-2010 and the amount that the Companies added to its test year revenues in its surrebuttal testimony is significantly less than the amount charged historically. Further, it is also less than the amount estimated by the Companies in their rebuttal testimony.

The Companies object to Staff's contention that they have not supported their FDC calculation. *Id.* at 10:201-204; NS-PGL IB. p. 82. The Companies' support is based on time records provided to Staff in discovery - Staff Ex. 18.0, Attachment B – Companies responses to Staff DR DAS 7.02h. While the data does show where the Companies derived the amounts charged to PEHS, there is no evidence that the time billed to PEHS was the total amount of time spent on these repairs. This can be seen by noting that the average charges for non-PPP ratepayers for the exact same service as PPP is almost twice as high as the average charges that PEHS pays for PPP. As noted, the Companies themselves claim that the only difference in the costs between the repair services is the profit margin. Staff Ex. 18.0, Attachment H – Companies responses to Staff DR DAS 9.08. However, as Staff demonstrated, in order for the Companies' charges to PEHS to really be at FDC the profit margin on non-PPP repairs charged to ratepayers must be 70 -115%. Staff IB, pp. 48-49. The Commission should not allow the Companies to charge a profit margin on a service to ratepayers without requiring the same margin to be charged to an affiliate.

The Companies again claim that the revised revenue requirements presented in their surrebuttal testimony are the correct amounts. NS-PGL IB, p. 82. The amounts in surrebuttal testimony are based on an average of the amount charged to PEHS from 2005-2010. NS-PGL Ex. 38.0, p. 10. If it significantly discounted those amounts during this period as Staff maintains, then the test year amount is significantly below FDC.

Once again the Companies misread the STA by claiming, "The Utilities are required to charge PEHS the FDC, and are not required to charge the same amount charged to customers [citation omitted]." NS-PGL IB, p. 82. Regardless, the Companies are required to charge a Commission-approved amount. The Commission should exercise its authority and require that PEHS be charged for repairs at the same rates it charges non-PPP customers. It is unreasonable for the Companies to charge their affiliate half of what they charge their ratepayers for the same services, without permitting ratepayers to benefit from this same margin in establishing test year revenues.

Staff continues to believe that the Commission should order the Companies to charge PEHS the same rate that they charge ratepayers. The full amount of those charges of $17,313 for Peoples Gas and $2,456 for North Shore should be included in the test year instead of the difference between them and the test year amounts.

b. Other Issues Relating to PEHS and PEPP, Including Staff Request for Investigation

Staff recommended that the Commission order an investigation into the Companies dealings with their affiliates and the support for PPP in general to establish that the interactions between the utilities and their affiliates are in the public interest. Staff IB, pp. 50-51.

The Companies object that “The amounts involved do not justify the burdens and costs of such steps. The impact of the 2012 test year solicitation revenues, properly calculated, on the Utilities’ forecasts are just $16,572, as noted above. The missed billings for repairs in 2008 to 2010 were just a total of $7,174 for Peoples Gas and $910 for North Shore, as noted above.” NS-PGL IB, p. 82.

An entire rate case was insufficient to determine the full extent of the Companies’ interactions with its affiliates. Thus, Staff believes that an investigation is still warranted. The “burdens and costs” of an investigation is small compared to the potential harm done to ratepayers over time. Staff estimates the margin on PPP is around $700,000 per year, which is not insignificant. “Larger amounts potentially would be at stake if the solicitation and repairs amounts were to be calculated as Staff proposes, but, as discussed earlier, Staff’s proposals are incorrect.” NS-PGL IB, p. 82.

If the Companies are willing to stop facilitating solicitation of their ratepayers by affiliates for affiliate products, to stop performing repairs for their affiliates, and to allow alternative suppliers to bill on the utility bill for competitive products, then Staff would recommend that those steps are sufficient to avert this process.

c. Warranty Products (Revenue and Non Revenue)

IGS recommends that the Commission require the Companies to provide other warranty suppliers with equal access to the bill. IGS IB, p. 8. Staff supports this requirement.

IGS recommends that the Commission require the Companies to provide other warranty suppliers with equal access to the solicitation channels used by PEHS. IGS IB, pp. 8-9. Staff does not support this recommendation. At present, the impact of this on ratepayers is unclear. Staff generally does not support the solicitation of ratepayers for any non-utility service provided by any party. There is insufficient evidence in this case of how IGS' recommendation would be implemented. This matter could be better considered in the recommended investigation proceeding.

D. Taxes Other Than Income Taxes (Payroll and Invested Capital Taxes) (Uncontested Except for Derivative Adjustments from Contested Adjustments)

E. Income Taxes (Including Interest Synchronization) (Uncontested Except for Derivative Adjustments from Contested Adjustments)

F. Gross Revenue Conversion Factor

1. Uncollectible Rate

Staff has not changed its position on this issue. Staff IB, p. 51.

2. Derivative Adjustments from Contested Adjustments

VI. RATE OF RETURN

A. Overview

In accordance with the ALJs' October 5, 2011 ruling granting in part Staff's Motion to Amend the Briefing Schedule, the Rate of Return portion of Staff's reply brief will be filed on October 11, 2011.

B. Capital Structure

1. Peoples Gas

2. North Shore

C. Cost of Long-Term Debt

1. Peoples Gas

2. North Shore

D. Cost of Short-Term Debt

1. Peoples Gas

2. North Shore

E. Cost of Common Equity

1. Peoples Gas

a. Staff's Analysis

i. DCF Analysis

ii. Risk Premium Analysis

iii. Recommendation

iv. Rider ICR

b. Response to Criticisms of Staff's Analysis

c. Companies' Analysis

i. Risk premium analysis flaws

ii. DFC Model

iii. DCF Growth Rates

iv. Leverage Adjustment

v. Size Adjustment

2. North Shore

F. Weighted Average Cost of Capital

1. Peoples Gas

2. North Shore

VII. WEATHER NORMALIZATION (Uncontested)

VIII. RIDERS – NON-TRANSPORTATION

A. Riders UEA and UEA-GC

Staff continues to recommend that, for Riders UEA (Uncollectible Expense Adjustment, applies to classes 1,2,4, and 8) and UEA-GC, the Commission order the Companies to switch from using the uncollectible amount set forth in Account 904 to using net write-offs in each tariff. To be consistent with Section 19-145 (a) of the Act, the Commission should also order that net write-offs be used to determine the utility's uncollectible amount in rates.

The Companies state that their proposed Rider UEA-GC is consistent with the requirement in the stipulation approved by the Commission in Docket Nos. 09-0419 and 09-0420 ("Stipulation") that the rider be "similar to" an uncollectible gas cost rider that the Companies had proposed, but withdrawn, in their 2009 rate cases. NS-PGL IB, p. 122. The stipulation, however, does not define the method for determining the amount of the uncollectible expense to include in utility rates or set forth a method for determining the amount of uncollectible expense to be recovered through riders. The stipulation does not limit the Commission's discretion in determining the method for computing the appropriate amount of uncollectible expense to be billed to customers. Therefore, using the net write-off method to determine uncollectible expenses is perfectly consistent with the Stipulation. Staff IB, p. 90.

The Commission should order the Companies to use net write-off method to determine the uncollectible amount to be recovered in Rider UEA. If the Commission orders the Companies to use the net write-off method in Rider UEA, the Commission, for consistency, should make the same order for the Proposed Rider UEA-GC.

B. Rider VBA

1. Merits of Rider VBA

Staff continues to support making Rider VBA permanent rather than increasing the percentage of fixed costs that are recovered through fixed customer charges. Staff does not agree with the Attorney General's assertion that no other utilities that have energy efficiency programs have decoupling mechanisms to recover fixed costs. Recovering high percentages of fixed costs through fixed charges, such as the 80% that is currently being recovered by Ameren (electric and gas) and Nicor serves to diminish the impact of sales volumes on revenue collection. Although it does not completely decouple revenue collection from sales volumes, it serves to diminish risks from variability in sales and stabilize revenues. Staff also believes the passage in which the AG makes this claim misrepresents previous Commission action and is counter to the arguments the AG made in the docket to which it cites. Specifically, the AG's brief states:

> It is worth noting, too, that should the Commission grant the Companies' request to approve Rider VBA on a permanent (or even a continued pilot) basis, PGL and North Shore would be the only utilities in the state to have recovery of their approved revenue requirements *guaranteed* through Rider VBA. Neither Commonwealth Edison nor Ameren, utilities that have been operating energy efficiency programs since 2008, have decoupling mechanisms to recover lost revenues associated with energy efficiency or to otherwise help recover "fixed costs", as NS-PGL claims they need. Northern Illinois Gas Company ("Nicor") specifically requested the approval of a cost recovery mechanism that recovered so-called "lost revenues" associated with their proposed programs in its Section 8-104 petition filed last year. ICC Docket No. 10-0562, Ex 3.0 (Malcolm Quick testimony) at 7-10. That request, like the NS-PGL request, claimed such a

mechanism was needed to ensure "fixed cost" recovery established in the last rate case. That request was denied.

AG brief pp. 46-47.

Dr. Brightwell's testimony supported making Rider VBA permanent because the Commission promoted revenue stability for Ameren's gas utilities and Nicor by approving rates that recovered 80% of fixed costs through fixed charges in those utilities' most recent rate cases. Staff Ex. 6.0, p. 2. Dr. Brightwell argued that Rider VBA was a better alternative in the case of Peoples and North Shore Gas for numerous reasons which are set forth in Staff's Initial Brief. None of Staff's reasons included encouraging utilities to increase the promotion of energy efficiency. The reasons included increasing incentives for customers to conserve, to protect customers from asymmetric risks of over and under collection and to reduce the redistribution of cost recovery from higher volume users to lower volume users. See Staff Initial Brief pp. 91-95. Staff also notes that the AG is incorrect with respect to the electric utilities as well. The Commission increased the percentage of fixed costs ComEd recovers through fixed charges from 37% to 50%. The Commission also referred to its increases in fixed cost recovery for Nicor and Ameren as decoupling and indicated that the increase to only 50% for ComEd was to avoid rate shock, hinting that larger percentages of fixed costs may be recovered through fixed charges in the future. See Docket 10-0467, Final Order dated May 24, 2011, pp. 231-232.

The AG also claims that the Commission denied Nicor's request to recover revenues lost due to energy efficiency measures in Docket 10-0562. The AG fails to adequately explain, however, that the issue was never brought before the Commission since the testimony of Malcolm Quick cited above was stricken from the record when the ALJ upheld a Joint Motion to Strike by CUB and the AG. Docket 10-0564, Notice of Administrative Law Judge Ruling, dated November 12, 2010. Amongst the reasons that CUB and the AG argued that the testimony should be stricken were concerns about single issue ratemaking that should be addressed in a rate case rather than an energy efficiency docket. Docket 10-0564, Motion to Strike and Deny the Request for an Expedited Schedule of the Citizen's Utility Board and the People of the State of Illinois, dated October 25, 2010, pp. 7-8. The AG now argues in this rate case that Rider VBA should not be made permanent because the Commission did not approve a lost revenue recovery rider for Nicor. Staff is perplexed by the irrational circularity of the AG's reasoning. For these reasons as well as the reasons Staff provided in its initial brief, Staff continues to recommend that if the Commission believes revenue stability is a desirable goal, it should approve Rider VBA on a permanent basis rather than move to a fixed straight variable rate or a rate that recovers 80% of fixed costs through fixed customer charges.

2. Tariff Language

The Companies took issue with some of Ms. Ebrey's proposed language changes to Rider VBA. The Companies claimed that Ms. Ebrey's proposal did not take into account customer migration. Companies IB, pp. 126-127. While the Companies claim explanation was provided regarding customer migration between rate classes and the factor causing said migration, Id., p. 128, they also acknowledge that such migration may not occur at the levels seen during 2009 and 2010. Staff IB pp. 95-96. Therefore, the added complication of the Companies' proposal to adjust revenues due to migration should be rejected.

C. Rider ICR

1. Accumulated Deferred Income Taxes

Staff's position on this issue is unchanged. Staff IB, p. 96. Staff agrees with the Attorney General that there are potential complications related to the annual reconciliations of plant additions, AG IB, p. 65, but maintains that adding ADIT to rider ICR introduces a complex element to the reconciliation which could overly complicate the reconciliation. However Staff would note that on September 30, 2011, the First District Appellate Court issued its opinion regarding the appeal of the Companies' 2009 rate cases (ICC Docket No. 09-0166/0167) and one of the issues on appeal concerned Rider ICR. The court held that the Commission exceeded its discretion in approving Rider ICR. People v. Illinois Commerce Comm'n, Nos. 1-10-0654, 1-10-0655, 1-10-0936, 1-10-179-, 1-10-1846 and 1-10-1852, Consolidated, Appellate Court (First District-Fifth Division) September 30, 2011, Slip Opinion, p. 28. Given that decision this issue would seem to be a moot point.

IX. COST OF SERVICE

A. Overview

B. Embedded Cost of Service Study

1. Uncontested Issues

a. Sufficiency of ECOSS for Rate Design

2. Contested Issues

a. Classification of Uncollectible Accounts Expenses Account No. 904

b. Classification of A&G Related to O&M

c. Classification of Fixed Costs

X. RATE DESIGN

A. Overview

B. General Rate Design

1. Allocation of Rate Increase

2. Uniform Numbering of Service Classifications

C. Service Classification Rate Design

1. Uncontested Issues

a. North Shore Service Classification No. 2

b. North Shore Service Classification No. 3

c. Peoples Gas Use of Equal Percentage of Embedded Cost Method (“EPECM”)

d. Peoples Gas Service Classification No. 2

e. Peoples Gas Service Classification No. 4

f. Peoples Gas Service Classification No. 8

2. Contested Issues – North Shore and Peoples Gas

a. Service Classification No. 1

D. Tariffs – Other Non-Transportation Tariff Issues

1. Uncontested Issues - North Shore and Peoples Gas

a. Terms and Conditions of Service

b. Service Activation Charges

c. Service Reconnection Charges

d. Rider 2

e. Rider 9

E. Bill Impacts

XI. Transportation Issues

A. Overview

B. Uncontested Issues

1. Allowable Bank (AB) Calculation

2. Rider CFY

3. Rider AGG (except Aggregation Charge)

4. Rider SBO

C. Administrative Charges

In its Initial Brief, Staff recommended that the Commission adjust test year expenses recovered in transportation tariffs downward by the amount proposed by Staff witness Sackett to reflect the Companies overly high projections of transportation expenses as evidenced by the Companies' consistent over budgeting of costs associated with transportation customers in each of the past three years. Staff IB, pp. 110-112.

The Companies claim that 8% is a significant level when it pertains to reduction in budget from the past rate case. NS-PGL IB, p. 147. However, this would indicate that the 16%-67% of historical over-budgeting is significant as well and cannot be ignored.

The Companies object to the method used by Staff to reduce the amount of these costs and argue that their budget is based on the best available information at the time it is created, NS-PGL IB, p. 148, and is under budget only due to "unanticipated events." Id. All of the unanticipated events listed reduce the actual costs from the budgeted amounts. However, all of them are related to the labor component which does not explain the Companies' under budgeting in other categories. Further, the Companies made no effort to explain why non-labor and IT costs were low. All costs for all years were below the budgeted amount.

The Companies did not provide any evidence that in years prior to the period reviewed by Staff that the labor budgets were at or above budget, or that this was a one-time, limited occurrence. They had an opportunity to provide such evidence but they could not. The total lack of any such evidence indicates that this is not a unique phenomenon.

The Companies assert that, "Mr. Sackett's approach of reducing the test year budget by calculating a factor by which cost categories in prior years' budgets exceeded actual costs (Sackett Dir., Staff Ex. 9.0, 7:141 - 8:147; Sackett Reb., Staff Ex. 18.0, 4:70-5:90) assumes that unexpected events that caused costs to be lower than forecast would occur again." NS-PGL IB, p. 148. The Companies characterization of this approach is incorrect. Mr. Sackett has not identified specific factors leading to change; rather he has pointed to a general trend likely caused by the Companies motive to cut costs that will be present in the test year. The trend is likely to reoccur even if Staff cannot identify the exact venue that will take.

The Companies also assert that Staff's method was incorrect because Staff did not identify specific factors that would cause the actual costs to be less for the test year. It is not Staff's task to *anticipate* specific "unanticipated events." The burden of proof is on the Companies; as noted above the Companies had ample time and data to demonstrate that these circumstances were anomalies and that on average over time the budgeted costs were good predictors of what actual costs would be. They could not to provide that evidence.

Because the Companies have historically had costs that have been under what they have budgeted, it is not reasonable to make ratepayers pay for the full amount of these forecasted expenses. Therefore, Staff continues to recommend that the Commission order that the test year expenses be reduced by the amount proposed by Mr. Sackett.

D. Large Volume Transportation Program

1. Administrative Charges

2. Transportation Storage – Issues

<u>Response to Companies</u>

As noted in its Initial Brief, Staff supports the unbundling and the elimination of standby proposals but soundly rejects the additional daily and monthly restrictions. Staff

IB, pp. 112-125. Illinois Industrial Energy Consumers ("IIEC") together with Constellation New Energy – Gas Division ("CNEG") have likewise rejected these restrictions. IIEC/CNEG IB, pp. 24-25.

The Companies initial brief identifies what it terms the "fundamental flaw," of Staff and intervenors criticisms of its proposal. According to the Companies the flaw "is that Staff and intervenors would perpetuate inter-class subsidies resulting from all classes of customers (sales, SVT and LVT) relying on the same storage assets but receiving different access rights." NS-PGL IB, p. 150. However, the Companies admitted that they had not attempted to establish the presence of inter-class subsidies, NS-PGL Ex. 46.0, p. 4, and the Companies have provided no evidence of these alleged inter-class subsidies. Staff IB, p. 120. It is impossible to perpetuate what does not exist.

The Companies also argue that "the same assets with the same contractual and operating capabilities support service to all the Utilities' customers. Allowing one class of customers superior rights to those assets necessarily means other customers are subsidizing those rights." NS-PGL IB, p. 151. The Companies argument assumes this is a zero sum game. However, this is not a zero-sum game. It is possible to have more flexibility than is needed most of the time and yet not have the actions of one group negatively impact the other groups. The Companies are trying to prevent the actions of an *individual* transportation customer or pool from having a negative impact on sales customers by altering the entire transportation program for all transportation customers. As Staff witness Sackett discussed in his direct testimony, the Companies' analysis improperly applies restrictions needed for the entire system onto individual customers, largely ignoring the diversity of transportation customers. Thus, the small amount of protection that the Companies' proposal offers comes at the price of a large amount of flexibility for transportation customers. This proposal will only reduce the efficiency of the transportation program without proportionate benefits for sales customers. Staff Ex. 9.0, p. 24. Thus, in addition to being unnecessary, the modifications put forth by the Companies are an overly strict method of accomplishing the Companies' aim.

Finally, the Companies assert that they have "developed a stand-alone storage service based on comprehensive modeling of the assets that support its ability to offer such a storage service. The proposal's key aspect is that all customer classes using these assets – sales, SVT and LVT – would have comparable rights and obligations. Said differently, customers receive the service for which they are paying and no customer class would subsidize another's use of storage." NS-PGL IB, p.155.

What the Companies fail to grasp is that by virtue of the design of transportation programs and the residual impact on sales customers, all capacity that is not utilized by individual transportation customers is available for use by sales customers. This is a benefit to sales customers[2] even if they do not use this capacity, because they have the option to use the underutilized capacity at no charge to them. The empirical evidence that those transportation customers as a group do not use their monthly inventories indicates that some of this seasonal capacity, which is paid for by transportation customers, is available to sales customers at all times. CNEG Exs. 1.4 and 1.5. This is

[2] A sales customer is a non-transportation customer; i.e. one that purchases commodity gas from the Companies at the PGA price. See, PGL Rider 2 – Gas Charge, ILL. C. C. NO. 28, Seventh Revised Sheet No. 33, (Canceling Sixth Revised Sheet No. 33); NSG Service Classification No. 1, Ill. C. C. NO. 17, Fourth Revised Sheet No. 6 (Cancelling First Revised Sheet No. 6) and PGL Service Classification No. 1, ILL. C. C. NO. 28, Fourth Revised Sheet No. 5 (Cancelling First Revised Sheet No. 5)

also likely to occur in other diversity-subject issues like daily restrictions. Tr., September 1, 2011, p. 720.

While the design of the proposed program alleges that it will be equal rights for all, any un-used capacity from transportation customers is available for sales customers; however, if the sales customers do not use their capacity, it is not available for transportation customers. The Companies' program does not work both ways. Additionally, the Companies acknowledge that while the Critical Day ("CD") withdrawal rights are proportional, non-CD withdrawal rights are less than proportional. Tr., September 1, 2011, pp. 716-717.

The Companies were even unable to convince their own affiliate, Integrys Energy Services ("IES"), an Alternative Retail Gas Supplier ("ARGS) that their proposals were necessary and reasonable; IES concurs with Staff's analysis and recommendations. IES IB, pp. 2 and 5.

Staff recommends that the Commission conclude that the Companies have not demonstrated the need for their proposed monthly storage limits and daily delivery restrictions. Therefore, the Commission should reject their proposals.

Response to IIEC/CNEG

IIEC/CNEG has recommended that if the Commission approves the daily and monthly target and associated cashouts that it also require the Companies to provide a deadband[3] around those targets that will enable the first 5% over the target to be cashed out at the market price. Although Staff is vehemently opposed to any new

[3] A deadband is a level of imbalances between deliveries and usage that is chased out without penalty at the market price.

restrictions and cashouts, Staff agrees that IIEC's version is more equitable than the Companies proposed cashouts.

IIEC/CNEG opposes the Companies proposals to institute Operational Flow Orders ("OFO") into the tariffs. However, Staff supports the Companies' proposal. While the Companies have not demonstrated that their system requires this restriction, all major LDC in Illinois have both Critical Days and OFOs.

3. Associated Rider Modifications

a. Rider SBS/SST

The Companies propose in their brief to eliminate Rider SST and implement Rider SBS as presented by the Companies in direct testimony. NS-PGL IB, pp. 155-156.

Staff believes that Rider SBS should be implemented with the operational parameters of Rider SST in place with the one exception being that for Supply Shortage Critical Days the percentage that the Companies have proposed are proportional and acceptable to all parties.

IIEC/CNEG has proposed that if the Commission deems the daily and monthly operational parameters are necessary for Rider SBS, then Rider SBS should be scrapped entirely and Rider SST left in place. IIEC/CNEG IB, p. 25. Staff believes that Rider SST is marginally better than Rider SBS with all of the unnecessary daily and monthly parameters in place. However, this would leave all of Staff's concerns from the past rate case that Rider SST customers cannot have access to bank without buying the unneeded standby that is linked to it still unresolved.

b. Rider FST

Rider FST is the Companies LVT tariff for smaller transportation customers. It has more flexibility than Rider SST and is monthly balanced. The Companies have proposed to add certain restrictions on to Rider FST to keep it in line with their proposals for SBS parameters.

The Companies attempt to justify their modifications to Rider FST in their Initial Brief.

> The proposed Rider FST changes are fully supported by the modeling that underlies the current SVT program and proposed Rider SBS. Just as it is appropriate to remove subsidies from sales customers to transportation customers, it is important that the different LVT riders operate under the same equitable access to storage parameters.
> NS-PGL IB, p. 157.

However, as Staff pointed out in its Initial Brief, if those customers subscribe to full standby so that they can have full standby on a Critical Day, then the value of this service would be fundamentally reduced. The Companies are proposing to eliminate a popular service by making Full Standby Service full standby in name only. Since the Companies are currently providing this full standby service year round the underlying assets have not changed. Staff continues to recommend that the Commission reject the Supply Shortage Day delivery requirement for Rider FST. Staff IB, pp. 126-128.

In the alternative, if the Commission determines that it is necessary to turn "Full Standby" into something less than its name implies, then the Commission should require the Company to change the name of the service to Limited Standby Service to reflect what it would become and to provide its customers with a broader reduction in costs. Staff recommends that the amount that these costs are reduced be equal to the amount that those customers are required to deliver for each utility. In other words, reduce non-storage costs by 27% for Peoples Gas and 39% for North Shore.

c. Rider P

Rider P provides for pooling of a supplier's transportation customers in order to make transportation service more efficient. The Companies propose to revise Rider P to address changes to Rider FST and proposed Rider SBS. NS-PGL IB, p. 157.

Staff recommends that this rider be unchanged except to make it consistent with the finally approved version of Rider SBS.

IIEC/CNEG argues that "If the Commission on the other hand adopts IIEC's modifications to Rider SBS corresponding modifications should be made to Rider P (i.e. modifications relating to any limits or restrictions on use of storage). If the Commission adopts Staff witness Sackett's proposal for unbundling then the Utilities would need only to make the conforming changes to Rider P. Sackett Sept. 1 Tr. at 763; IIEC/CNEG IB, p. 27.

IIEC/CNEG has recommended that, if the Commission does approve the daily and monthly targets, that it require the Companies to provide super pooling across all of a supplier's pools, including those on Rider FST. It asserts that this is the case in the present tariff. IIEC/CNEG would like to see that super-pooling expanded to monthly parameters. IIEC/CNEG IB, p. 27.

If the Commission orders the implementation of these daily and monthly parameters, then Staff supports the super-pooling recommendations of IIEC/CNEG and would also support super-pooling for daily parameters as it is appropriate to take as much diversity into account as possible. The Companies have acknowledged that diversity applies to daily parameters as well as monthly and seasonable ones. Tr. p. 720, September 1, 2011.

d. Rider SSC

The Companies propose to revise Rider SSC Storage Service Charge, to accommodate their storage unbundling proposals. NS-PGL IB, pp. 157-158.

llEC/CNEG continue to recommend the rejection of Rider SBS. Without Rider SBS, Rider SSC is unnecessary. However, if the Commission determines Rider SBS should be adopted with the critical changes recommended by llEC/CNEG or if the Commission adopts the position of Staff witness Sackett, Rider SSC would be necessary to unbundle and recover the base rate storage costs from Sales [sic.] customers. IIEC/CNEG IB, p. 28.

Staff continues to recommend that this rider be approved.

e. Transition Riders

Staff recommends that these proposed riders be changed to make them consistent with the finally approved version of Rider SBS.

E. Small Volume Transportation Program (Choices for You[SM] or "CFY")

1. Aggregation Charge

IGS proposes to have administrative costs supporting the Companies Small Volume Transportation ("SVT") programs recovered from all customers eligible for these programs rather than those only participating in them. Staff believes that there is no reason for sales customers to bear any portion of the administrative costs supporting transportation programs. Staff Ex. 18.0, p. 6-7. The costs for these programs, while over-budgeted, have been and continue to be for costs exclusive to transportation programs.

IGS, in its Initial Brief, argues that the there is an overlap between the services provided by Gas Transportation Services ("GTS") and the services provided in support of all customers. IGS IB, pp. 12-14. Gas Transportation Services ("GTS") exists to support the SVT programs, Choices For You ("CFY"), and Large Volume Transportation ("LVT") programs, Full Standby Transportation service ("FST") and Selected Standby Transportation service ("SST"). It supports CFY primarily by supporting the CFY *suppliers* providing services under Rider AGG. Thus the call center services provided by GTS are primarily handling calls from *suppliers* regarding their receipt of services from the Companies. NS-PGL Ex. 28.0, p. 41.

Similarly, the billing provided by GTS goes to the suppliers for services received under Rider AGG and the collection of these same administrative charges. Lastly, the bill reconciliation that is conducted is to reconcile Rider AGG suppliers' bills, not CFY customers. Therefore, while the services provided under GTS are similar to those provided for all customers, they are distinct in that they primarily support AGG *suppliers* not CFY *customers*.

The Companies have used an allocator to allocate labor costs for GTS because not all of the work performed by GTS is in support of transportation programs. They used the fraction 15/17th because that was the estimated level. Tr., September 1, 2011, pp. 672-684. IGS opposes using this allocator because the Companies do not have a specific calculation upon which to base this allocation. IGS IB, pp. 17-24. The use of an allocator is appropriate in this case because the level of allocation is close to the amount one would expect given the nature of services provided and the types of other non-transportation tasks described by the Company witness. While it is possible that these employees are working on other tasks for the Companies that are not related to transportation service, it is clear that the work of supporting these suppliers is occurring. No party maintains that no one is performing the listed functions and it seems reasonable that it is this group.

The amount of overlap is likely to be *de minimus* and while "similar" services may be performed by each group, the services performed by GTS, by-and-large, are services for transportation customers either ratepayers or suppliers. There is no evidence that sales customers call GTS. Tr., September 1, 2011, p. 675. Even if services overlap somewhat, there is no evidence that the costs overlap; i.e., that the Companies are over-recovering. NS-PGL IB, p. 161.

IGS points to call center activity to support its proposal to have all administrative costs borne by all eligible customers. IGS IB, pp. 12-13. While CFY customers do pay for the main call center through base rates, CFY customers benefit from the main call center and will call in to that call center with basic CFY calls. So the main call center performs services related to utility distribution services, utility commodity services and transportation commodity calls. That call center will refer those customers to their suppliers or to GTS.

To support its position that all eligible customers benefit from SVT, IGS claims that the Companies concede this point. "In this proceeding, IGS has developed substantial additional evidence, demonstrating that all eligible customers do benefit from the Choices For You program; and *the Companies have confirmed that evidence*. (*See,* *e.g.*, IGS Ex. 1.0 at 31:740-743, 33:788-794; Tr. at 692:6-693:15.)" IGS IB, pp.17-18, emphasis added.

The Companies never confirmed this assertion. What the witness stated was that *if* the customer group benefits, they should be charged their "fair share" of the cost. When asked, "And we'd agreed earlier that as a general matter, if a customer group benefits from a program, it should be allocated its fair share of the cost, right?," the Company witness responded, "Correct." Tr., September 1, 2011, p. 693. Thus the Companies agreed that if there was a benefit, it should be paid. It did not confirm that this benefit existed.

IGS also contends that the Commission directed the Companies to implement this feature of the Nicor's SVT program. "The Companies … have not presented any explanation as to why they failed to follow the Commission's directive." IGS IB, p. 25. However, the directive and requirement for this discussion and inclusion was directed at operational parameters, not administrative costs. The Commission only instructed the parties to address these matters in those workshops. Those matters were discussed, but there was no consensus.

That order confirms that the Commission was not inclined to require any socialization but rather only that the matter must be addressed in the workshop, which it was. "At this point, the Commission adopts the Utilities' position to recover these costs through specific charges to suppliers. Because the Commission has adopted Staff's position to hold workshops, *the Administrative Costs are matters that can be reviewed in that forum*. See the discussion of the adoption of the workshop process above." Order, January 21, 2010, Docket No. 09-0166/0167 cons., p. 260, emphasis added.

Thus Staff still supports the separate recovery of these costs exclusively from suppliers. However, given that there is not a basis for the 15/17th labor allocation used by the Company to allocate the costs of GTS to SVT customers, Staff supports IGS's recommendation that the Commission require the Companies to undergo a detailed cost study and time recording between this rate case and the next in order to have better records of time allocation for GTS labor. This measure of the historical time allocation in support of transportation services would provide a firmer basis to address this issue in a future rate case.

2. Purchase of Receivables (withdrawn)

XII. CONCLUSION

Staff respectfully requests that the Illinois Commerce Commission approve Staff's recommendations in this consolidated docket.

Respectfully submitted,

JOHN C. FEELEY
MICHAEL LANNON
NICOLE LUCKEY
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle Street, Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
Fax: (312) 793-1556
jfeeley@icc.illinois.gov
mlannon@icc.illinois.gov
nluckey@icc.illinois.gov

Counsel for the Staff of the Illinois Commerce Commission

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